

Message Text

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C O N F I D E N T I A L SECTION 1 OF 2 ROME 13849

USEEC ALSO FOR EMBASSY

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SUBJECT: ITALY AND EUROPEAN MONETARY UNION

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1. SUMMARY. THE RELAUNCHING OF THE PROCESS OF EUROPEAN MONETARY UNION AT BREMEN HAS RAISED BOTH HOPES AND DOUBTS ABOUT ITALY'S ROLE IN SUCH A SCHEME. WHILE THE GOVERNMENT HAS RESERVATIONS ABOUT MANY ASPECTS OF THE BREMEN PROPOSAL, IT SEES IMPORTANT POLITICAL AND ECONOMIC BENEFITS DERIVING FROM PARTICIPATION IN A EUROPEAN CURRENCY BLOC. IN ESSENCE, THE GOI FEARS THE CONSEQUENCES OF BEING "LEFT BEHIND" BY NON-PARTICIPATION IN A NEW EUROPEAN MONETARY SCHEME AND BELIEVES THAT PARTICIPATION WOULD REINFORCE GOVERNMENT EFFORTS TO BRING ABOUT STRUCTURAL CHANGES IN THE ECONOMY. THEREFORE, THE ATTITUDE OF THE GOI HAS BEEN ONE OF ACCEPTANCE, TEMPERED BY CLEAR INDICATIONS THAT IT WILL WORK TO INFLUENCE THE FINAL SHAPE OF THE AGREEMENT--HOPING TO ASSURE THAT THE SYSTEM IS COMPATIBLE WITH ITALY'S ECONOMIC STRUCTURE. THE GOVERNMENT HAS RECEIVED SIGNIFICANT POLITICAL SUPPORT FOR ITS POSITION.
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HOWEVER, A NUMBER OF PEOPLE, INCLUDING THE TOP ECHELON OF THE BANK OF ITALY, LOOKING AT THE PROPOSAL IN PURELY ECONOMIC TERMS, HAVE VERY SERIOUS DOUBTS ABOUT THE FEASIBILITY OF ITALY'S PARTICIPATING IN A NEW EUROPEAN MONETARY SYSTEM UNDER PRESENT DOMESTIC ECONOMIC CONDITIONS.
END SUMMARY.

2. THE IDEA OF ITALIAN PARTICIPATION IN A NEW EUROPEAN CURRENCY BLOC HAS BEEN GAINING RECEPTIVITY SINCE THE BREMEN SUMMIT. WHILE THE INITIAL REACTION WAS MILDLY FAVORABLE, ONE NOW GETS THE CLEAR IMPRESSION FROM DISCUSSIONS WITH THE TREASURY MINISTER (REFTEL) AND OTHER GOVERNMENT OFFICIALS THAT THE PROSPECT OF JOINING SOME NEW KIND OF EUROPEAN MONETARY ARRANGEMENT IS INCREASINGLY PERCEIVED AS AN OPPORTUNITY NOT TO BE MISSED. THREE RELATED REASONS SEEM TO UNDERLIE THIS POSITION: (A) ITALY MUST REMAIN A FULL MEMBER OF THE EUROPEAN COMMUNITY: PARTICIPATION IN THE EUROPEAN MONETARY UNION IS REGARDED AS AN ESSENTIAL ASPECT OF SUCH MEMBERSHIP. JOINING THE MONETARY ARRANGEMENT IS SEEN AS A MEANS OF GAINING A FURTHER COMMITMENT FROM THE SOCIALISTS--AND TO SOME EXTENT EVEN FROM THE COMMUNISTS--TO COOPERATE WITH EC POLICIES AND INSTITUTIONS; (B) NON-PARTICIPATION WOULD NECESSARILY RELEGATE ITALY TO A POSITION OF ECONOMIC INFERIORITY WITHIN THE COMMUNITY--A "SECOND TIER" OR, AS SOME OBSERVERS PUT IT, A MEDITERRANEAN RATHER THAN A EUROPEAN COUNTRY; AND (C) JOINING A CURRENCY ARRANGEMENT IS SEEN BY SOME AS IMPOSING ADDITIONAL ECONOMIC DISCIPLINE WHICH WOULD FORCE THE POLITICAL PARTIES TO TACKLE THE COUNTRY'S ECONOMIC PROBLEMS.

3. HAVING SAID THIS, HOWEVER, ITALIANS HAVE FEW ILLUSIONS ABOUT THEIR ECONOMY'S PRESENT CAPACITY TO
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REMAIN IN A SYSTEM WHICH WOULD RIGIDLY TIE ITS EXCHANGEURR RATE TO A STRONG CURRENCY LIKE THE DEUTSCHEMARK. HENCE, THE GOI WILL TRY TO NEGOTIATE AN ARRANGEMENT WHICH WOULD BE BOTH GRADUAL IN IMPLEMENTATION AND FLEXIBLE ENOUGH TO ALLOW ITALY TO PARTICIPATE FROM THE START. THIS IS NECESSITATED BY THE WEAKNESS OF THE ITALIAN ECONOMY RELATIVE TO THOSE OF THE OTHER POTENTIAL PARTICIPANTS IN THE MONETARY SCHEME, ESPECIALLY AS REGARDS THE RATES OF INFLATION AND ECONOMIC GROWTH. AS PANDOLFI INDICATED TO THE AMBASSADOR, ITALY IDEALLY WOULD LIKE TO SEE AN ARRANGEMENT WHERE THE PARITIES COULD BE CHANGED AT THE DISCRETION OF INDIVIDUAL MEMBERS.

4. POLITICAL CONSIDERATIONS ARE, THEREFORE, A KEY ELEMENT IN THE ITALIAN POSITION ON MONETARY UNION.

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THIS IS RELATED IN PART TO A CONCERN BY MANY THAT ITALY NEEDS CONTINUALLY TO STRENGTHEN ITS TIES TO THE COMMUNITY LEST IT FALL INTO "SECOND CLASS STATUS." THIS PSYCHOLOGY WAS POINTEDLY BROUGHT OUT BY PANDOLFI WHEN HE STATED PRIVATELY THAT IF ITALY DID NOT "GO WITH EUROPE," IT WOULD BE CONDEMNED TO JOIN THE MALTAS AND LIBYAS OF THE WORLD. BECAUSE OF THIS FEELING, ITALY WILL PROBABLY NOT BE AS PERSISTENT IN ITS DEMANDS FOR AMENDING THE BREMEN PROPOSAL AS IT MIGHT OTHERWISE BE. IT MAY LOOK TO THE UK TO TAKE THE LEAD IN RESISTING FRENCH-GERMAN PRESSURES.

5. THE GOVERNMENT'S POSITION HAS RECEIVED SUPPORT FROM THE CHRISTIAN DEMOCRATS, REPUBLICANS AND LIBERALS. HOWEVER, THERE IS ALSO SOME DISSENT ON THE GROUND THAT EUROPEAN MONETARY UNION IS NOT IN THE BEST ECONOMIC INTERESTS OF THE COUNTRY. THESE DISSENTERS INCLUDE LUIGI SPAVENTA, A WELL-KNOWN ECONOMIST AND AN INDEPENDENT DEPUTY ELECTED ON THE PCI LIST IN THE LAST ELECTION, WHO IS ONE OF FEW TO HAVE PUBLICLY CRITICIZED PANDOLFI'S PRO-MONETARY UNION STAND. WE UNDERSTAND THAT THE BANK OF ITALY, PARTICULARLY AT THE TOP ECHELON, ALSO HAS SERIOUS RESERVATIONS BUT, IN ACCORDANCE WITH BANK PRACTICE, HAS NOT MADE THEM PUBLIC. THE BANK OF ITALY WILL UNDOUBTEDLY BE WORKING BEHIND THE SCENES IN COMING MONTHS, TRYING TO

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EXTRACT THE BEST CONDITIONS FOR ITALY IN ANY NEW MONETARY ARRANGEMENT.

6. THOSE WHO DISSENT ARGUE AS FOLLOWS: PEGGING THE LIRA TO THE EUROPEAN CURRENCY UNIT (ECU) MEANS, IN EFFECT, TYING THE LIRA TO THE DM. THE LIRA WOULD TEND TO APPRE-

CIATE AND ITALY WOULD THUS LOSE COMPETITIVENESS SINCE RELATIVE INFLATION RATES ARE NOT LIKELY TO BE EQUALIZED THE THE NEAR TERM. ACCORDINGLY, IF ITALY IS TO REMAIN IN THE SYSTEM, IT MUST EITHER SUPPORT AN UNREALISTIC EXCHANGE RATE OR RUN ITS ECONOMY IN LOWER GEAR. ON THE OTHER HAND, THEY MAINTAIN, KEEPING THE LIRA PEGGED TO THE DOLLAR GIVES ITALY THE BEST OF BOTH WORLDS. IT GIVES THE COUNTRY A STABLE LIRA-DOLLAR RATE, WHICH HAS BOTH ECONOMIC AND PSYCHOLOGICAL SIGNIFICANCE, WHILE GAINING COMPETITIVENESS AGAINST GERMANY AND OTHER STRONG CURRENCY COUNTRIES.

7. WHILE THIS IS A VALID ARGUMENT, IT LEAVES TWO QUESTIONS UNANSWERED. ONE, WHAT WOULD HAPPEN TO THE LIRA IF IT REMAINED OUTSIDE A NEW EUROPEAN ARRANGEMENT AND THE DOLLAR STRENGTHENED SIGNIFICANTLY OVER A SHORT PERIOD OF TIME? TWO, WOULD ITALY BE ABLE TO SOLVE ITS ECONOMIC PROBLEMS AND KEEP THE ECONOMY ON A STABLE NON-INFLATION GROWTH PATH WITHOUT THE ADDITIONAL EXTERNAL PRESSURE AND DISCIPLINE THAT MONETARY UNION IS SUPPOSED TO BRING?

8. BY REMAINING OUTSIDE A EUROPEAN MONETARY SCHEME, THE LIRA WOULD NO DOUBT BE IN AN EXPOSED POSITION SHOULD THE DOLLAR STRENGTHEN SIGNIFICANTLY OVER A SHORT PERIOD OF TIME. ITALY MAY HAVE TO DEFEND THE LIRA WITHOUT THE ADDITIONAL FUNDS THAT THE POOLED RESERVES OF THE COMMUNITY

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WOULD PROVIDE.

9. THE EFFECTIVENESS OF EXTERNAL PRESSURE IN FORCING ITALY TO TAKE THE NECESSARY MEASURES TO SOLVE ITS INTERNAL PROBLEMS SHOULD NOT BE OVERSTATED. IN THE FIRST PLACE, IT IS NOT TRUE THAT ITALY DOES NOT NOW OPERATE WITHOUT EXTERNAL DISCIPLINE. GIVEN THE STRONG BELIEF OF THE BANK OF ITALY AND THE GOVERNMENT THAT THE VICIOUS CIRCLE OF DEVALUATION-INFLATION IS OPERATIVE IN ITALY, THE MONETARY AUTHORITIES HAVE A STRONG PREFERENCE FOR THE MAINTENANCE OF A STABLE EXCHANGE RATE AND HAVE FORMULATED THEIR POLICIES ACCORDINGLY. SECOND, THE GOVERNMENT MAY WELL HAVE INFLATED EXPECTATIONS ABOUT THE USEFULNESS OF THE SOCIAL CLASSES TO FACE THE DIFFICULT DECISIONS REQUIRED TO SOLVE THE COUNTRY'S PROBLEMS. RECENT ITALIAN GOVERNMENTS HAVE TRIED TO USE THE IMF FOR THIS PURPOSE WITH ONLY MODEST SUCCESS. OF COURSE, PRESSURES FROM A EUROPEAN MONETARY FUND WOULD CARRY MORE WEIGHT. NEVERTHELESS, ITALY CAN SOLVE ITS ECONOMIC PROBLEMS ONLY THROUGH A SERIES OF MEASURES ON WHICH A CONSENSUS WILL HAVE TO BE FORGED AMONG DIFFERENT POLITICAL AND SOCIAL GROUPS. THESE WILL BE INFLUENCED

BY EXTERNAL PRESSURES ONLY TO A LIMITED DEGREE. IN
THE LAST ANALYSIS, ITALY CAN ONLY SOLVE ITS ECONOMIC
PROBLEMS IF IT FINDS STRENGTH FROM WITHIN. GARDNER

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